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Tax Court Delivers Major Tax Depreciation Victory For Electric Utility Industry in PPL v. Commissioner of Internal Revenue

On July 28, 2010, in *PPL Corporation & Subsidiaries v. Commissioner of Internal Revenue*, 135 T.C. No. 8, the United States Tax Court, in an opinion written by Judge James S. Halpern, held that street light assets owned and depreciated by an electric utility do not constitute assets used in the distribution of electricity for sale. Rather, the Tax Court found that street light assets are used to provide light for public safety. The difference is significant for federal income tax depreciation purposes — a 20-year depreciation recovery period vs. a 7-year depreciation recovery period.

The IRS had argued that street light assets were used to distribute electricity for sale, relying heavily on the physical aspects of electricity distribution and various regulatory codes and the FERC Uniform System of Accounts. If used to distribute electricity for sale, the street light assets would fall within the traditional asset guideline class for utility transmission and distribution assets, i.e., Asset Class 49.14, Electric Utility Transmission and Distribution Plant, IRS Revenue Procedure 87-56, 1987-2 C.B. 674, 685. Assets included in Asset Class 49.14 generally have a 20-year depreciation recovery period.

The electric utility industry, on the other hand, has long viewed street light assets as equipment that uses electricity to produce light — i.e., end-use or utilization equipment — and not as equipment that is used to deliver electricity to customers. If used to provide a lighting service and not to distribute electricity, the street light assets would fall within a residual category for assets without an assigned class life. I.R.C. § 168(e)(3)(C); Rev. Proc. 87-56, *supra* at 675. The residual category provides for a 7-year depreciation recovery period.

In the late '90s, many electric utilities, including PPL, reclassified their street light assets from Asset Class 49.14 to the residual category. The IRS disputed this reclassification and, in a series of informal administrative pronouncements and as part of an industry position, asserted additional tax liabilities based on the longer depreciation recovery period for distribution assets.

After a trial, the Tax Court resolved the dispute against the IRS and in favor of the electric utility industry. Based on the evidence presented by PPL, the Tax Court concluded that PPL's street lights were not used in the distribution of electricity for sale. The Tax Court rejected the IRS's reliance on

nontax regulatory regimes, such as the various electric safety codes and the FERC Uniform System of Accounts, as largely irrelevant or supportive of PPL's position. The Tax Court concluded that PPL had satisfied its burden of proof and had shown that street light assets were used in a separate activity from distribution of electricity for sale and constituted assets without a class life.

The Tax Court also rejected the IRS's alternative argument (raised for the first time in its briefing papers) that street light assets constituted land improvements under Asset Class 00.3, Land Improvements, placing the burden of proof on the IRS and holding that street light assets were neither intended nor were they in fact affixed

permanently to land and, consequently, were not land improvements.

The Tax Court opinion represents a resounding victory for the electric utility industry and will benefit electric utilities, ratepayers and municipalities, one of the primary customers for street lighting services. Even though the Tax Court's opinion was issued to PPL, the court's position is applicable to other taxpayers who own street light assets:

To be clear, we find that no one uses street light assets in the distribution of electricity for sale [W]e find that no one—not [PPL], not any municipality—uses street light assets

primarily for the distribution of electricity for sale.

The Tax Court followed its holding in *PPL in Entergy Corporation and Affiliated Subsidiaries v. Commissioner of Internal Revenue*, T.C. Memo. 2010-66, in an opinion released the same day as PPL.

Read a copy of the [Tax Court's decision in PPL](#).

Richard May, Mark Bierbower and Tim Jacobs of the tax controversy team at Hunton & Williams litigated the *PPL* case. Our tax controversy team consists of experienced tax practitioners and litigators. [Read our tax controversy practice description](#).

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